Spanair insolvency: Breach of the obligation to file for insolvency within two months is not enough to hold directors liable. A *rule of reason* decision.

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The Barcelona Court of Appeal has recently quashed a commercial court decision that declared culpable the insolvency (*concurso culpable*) of the Spanish airline Spanair due to the fact that the company had become insolvent in June 2011 but its directors did not file for insolvency until January 2012.

In 2008, Spanair's reference shareholder, the Scandinavian airline SAS, announced its intention to leave the company, that was already facing financial difficulties, as a result of different circumstances (the 9/11 attacks, the world's financial crash, an aircraft accident in August 2008, etc.). A viability plan was put in place and in April 2009 Iniciatives Empresarials Aeronautiques (IEASA), a company owned by private investors and public entities belonging to the Barcelona City Council and the Regional Government of Catalonia, acquired 80 percent of Spanair.

Despite a number of measures that were put in place, the company's financial situation got worse, and Spanair's new board of directors adopted new measures, including the search of an industrial partner. Conversations took place with different airlines, and in February 2011 Spanair signed a memorandum of understanding with Qatar Airways. According to the MoU Spanair needed an injection of funds between Euro 150 and 300 million. In addition, Spanair also held conversations with the Chinese company HNA Aviation.

In November 2011 a memorandum of interest was signed by the Regional Government of Catalonia with Qatar Airways for the acquisition by the latter of 49 percent of Spanair. The Regional Government of Catalonia undertook to finance the business until closing of the deal. However, in December 2011 Qatar Airways started to have doubts as to the legality of the investment by the Catalan public body, as it could be considered a state aid contrary to EU law. Meanwhile, negotiations were held with HNA Aviation.

In January 2012, after a meeting with the European Commission, the Regional Government of Catalonia publicly announced that it will not make any further investment in Spanair. As a consequence, on 30 January 2012 Spanair's board of directors decided to cancel all the company's flights and filed a petition for insolvency. Spanair's debts amounted to some Euro 572 million.

In September 2014, the Commercial Court No. 10 of Barcelona handed down a judgment declaring that Spanair's insolvency was culpable and that all its directors were jointly and severally liable for an amount of Euro 10.8 million. The reason was that the directors had breached their obligation to file for insolvency within two months from the day they became aware or should have become aware of the company's insolvency, which the Commercial Court considered to have happened in June 2011. According to the insolvency administrators, the company kept selling flights despite being insolvent.

The Court grounded its decision on section 165.1.1 of the Spanish Insolvency Act (SIA), according to which directors' breach of their duty to file for insolvency within the 2-month legal period triggers a rebuttable presumption of culpability.

The Commercial Court's decision was appealed before the Barcelona Court of Appeal, which on 29 April 2016 overturned the first instance decision.

The Court of Appeal found that Spanair was indeed insolvent on 30 June 2011. Therefore, it was clear that Spanair's directors had not filed for insolvency within the 2-month legal period. However, according to the Court of Appeal such circumstance was not *per se* sufficient to render the insolvency culpable and hold directors liable.

In the Court's view, Spanair's directors had deliberately avoided filing for insolvency, in an ongoing attempt to find a viability solution. And only when they realized that no reasonable solution was at hand, they decided to file for insolvency. Actually, the Court said that filing for insolvency earlier would have been negligent:

> *"the company (and its creditors) had much to win should an agreement was reached and not too much to lose".*

Indeed, according to the Court of Appeal, the decision to stop trading would have killed the process or substantially reduced the likelihood to reach an agreement with an industrial partner.

Therefore, according to this judgment, Spanair's directors breached a legal obligation (filing within the 2-month period), but did so in the best interest of the company and its creditors.

In our view, the judgment of the Barcelona Court of Appeal adopts a courageous and down to earth approach, beyond formalism and legalism. Indeed, experience shows that in many cases filing for insolvency is the end of the business. In those cases, a diligent director may be right in looking beyond the letter of the SIA (namely the 2-month period) and explore all possibilities to float the business out of court, "until all hopes are lost", as the Court of Appeal put it.

In reality, this approach is not only pragmatic and realistic, but also perfectly legal, given that directors must, first and foremost, act diligently at every moment. In other words, the most important and general duty a director has is to be diligent, and if, in certain circumstances, being diligent requires not to comply with the 2-month filing period, so be it.